B Mahapatra: Implications of new bank licences

Inaugural address by Mr B Mahapatra, Executive Director of the Reserve Bank of India, at the Post Graduate Students' Conclave on "Implications of new bank licences", at the National Institute of Bank Management, Pune, 28 September 2013.

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The assistance provided by Shri S.S. Barik, General Manager, RBI, is gratefully acknowledged.

1. I have great pleasure and privilege in associating myself with the conclave of the Post Graduate Students of National Institute of Bank Management (NIBM), Pune. I am indeed grateful to Director Allen C A Pereira for inviting me to deliver the inaugural address. NIBM is a premier educational institution of the country in the field of banking and finance and it is but natural for them to select a subject of topical interest for this conclave.

2. I understand that the objective of this conclave is to explore the implications of new bank licences on the banking sector, and that, some of the eminent bankers and CEOs of NBFIs, who have interest on the subject are also present to express their views, besides the students of the Institute. I am sure the conclave will generate a lot of heat and throw much light during its deliberations. I congratulate Director Pereira and his team for this.

The broad picture

3. Before I proceed with the subject, let me first present as a backdrop, a broad picture of today's Indian banking and financial system:

- Indian financial system is bank dominated – banks' share at 63 per cent of total assets of the financial system, is followed by insurance companies at 19 per cent, Non-Banking Financial Institutions at 8 per cent, Mutual Funds at 6 per cent and Provident and Pension Funds at 4 per cent, of the total assets of the financial system.
- Even among the commercial banks, public sector banks have dominant number of branches at about 67,000, followed by private sector banks at about 13,500 and foreign banks at about 325 branches, constituting 83 per cent, 16.6 per cent and 0.4 per cent respectively of the total number of over 100,000 branches of banks.

Licensing of new banks – a historical perspective

4. Historically, commercial banks in India were privately held. However, post-independence, from 1951, the Government of India adopted planned economic development for the country through Five Year Plans. The economic planning envisaged state ownership of the economic means of production to sub-serve the social welfare objectives of planning. The commercial banks lagged in attaining the social objectives. It was felt that banks controlled by business houses failed in catering to the credit needs of poorer sections of society, such as farmers, craftsmen, etc. and to the credit needs of small and cottage industries. Therefore, the Government of India nationalized 14 major commercial banks in 1969. All commercial banks with a deposit base over ₹ 500 million were nationalized then. These banks had 85 per cent of bank deposits in the country, at that time. The second phase of nationalization happened in 1980 when 6 more banks with deposits of ₹ 2 billion or more were nationalized and the Government of India controlled around 91 per cent of the banking business in India.

5. Subsequently, the Regional Rural Banks Act, 1976 was enacted to set up Regional Rural Banks (RRBs) under the joint ownership of Central Government, State Government and a sponsor bank, with a view to developing the rural economy by providing credit and

other facilities, particularly to the small and marginal farmers, agricultural labourers, artisans and small entrepreneurs, and other productive activities in the rural areas. This led to setting up of 196 RRBs across the country. However, no new licence was issued for setting up commercial banks in the private sector till early 1990s.

6. India faced a serious balance of payments crisis in 1991. The Government of India adopted a policy of economic liberalization. Therefore, the economic and banking policies were to be reversed to suit the requirements of a liberalized economy. The banking sector reform became inevitable to accelerate the pace of reforms to usher in a vibrant and competitive economy. An expert Committee under the Chairmanship of Shri M. Narasimham (a former Governor of RBI) was set up for spearheading the financial sector reform in India. The Narasimham Committee (*Committee on Financial Sector Reforms 1991*) inter alia, recommended opening up of the banking sector to the private entrepreneurs to bring in competition and efficiency, thereby paving the way for licensing of new commercial banks in the private sector. Since then, the Reserve Bank licensed 10 banks in the private sector in 1993–94, and 2 more in 2002–04 under the guidelines framed in 1993 and 2001 respectively. There were 157 commercial banks [26 public sector banks, 20 private sector banks, 43 foreign banks, 64 RRBs and 4 Local Area Banks (LABs)] as on March 31, 2013.

Need for new banks in the private sector

7. The Indian financial system has made impressive strides in resource mobilization, geographical and functional reach, financial viability, profitability and competitiveness, since nationalization of banks in 1969 and liberalization of economic policies since early 1990s. With the penetration of banks into the nook and corner of the country, the average population per branch office (APPBO) declined from about 64,000 in 1969 (as per 1961 census) to about a fifth of that number – 12,400 now as per 2001 census.

8. Notwithstanding the vast network of branches, a sizeable segment of population, especially the underprivileged sections of the society, have no access to formal banking services. There still exists a gap between the ever increasing demands for financial services of a growing economy and the available banking network to cater to the needs of the vast areas, which are unbanked or under-banked even today. Despite the progress made over the years since nationalization of banks in 1969, the problem of financial exclusion is staggering. According to the findings of World Bank Global Findex Survey (2012), only 35 per cent of Indian adults had access to formal bank account and just 8 per cent borrowed formally in the last 12 months. Only 2 per cent of adult population used bank accounts to receive money (remittances) from members of family living elsewhere and 4 per cent received payments from the Government.

9. Of the 600,000 rural habitations in the country, only about 40,000 had been covered by the presence of brick and mortar branches of banks. With regard to financial access and penetration, India ranks low compared with OECD countries. As of 2009, India had 6.33 branches per 100,000 persons whereas OECD countries provided 23–45 branches per 100,000 persons.

10. Presently, the share of public sector banks constitutes about 72 per cent of the total banking assets in India. With the implementation of Basel III capital norms, banks will need to raise more capital. As the Government's share in the capital of public sector banks is close to the minimum of 51 per cent, raising of any additional capital by the public sector banks would require the Government to infuse matching capital so as to maintain its minimum shareholding at 51 per cent. Therefore, expansion of public sector banks into new areas would depend on the ability and willingness of the Government to infuse capital.

11. The private sector banks have a share of about 18 per cent of the total banking assets in India. The existing 13 old private sector banks, which have been in existence much before the Banking Regulation Act was enacted in 1949, together with the 7 new private sector banks, have been growing at 20 per cent. However, the performance of the old private

sector banks was not so impressive in the areas of branch expansion compared to their new peers in the private sector. While 13 old private sector banks together had 5,555 branches, 7 new private sector banks had 7,857 branches as on March 31, 2012.

12. The Government of India has adopted financial inclusion as a state policy. In order to achieve this objective, not only more number of branches, but also some more new banks are necessary, as stretching of the resources of the existing banks to fill the gap may not yield the desired results.

The genesis of the new bank licensing guidelines

13. The Union Finance Minister, in his Budget Speech for the year 2010–11 had stated, "*we need to ensure that the banking system grows in size and sophistication to meet the needs of a modern economy. Besides, there is a need to extend the geographic coverage of banks and improve access to banking services. In this context, I am happy to inform the Honourable Members that RBI is considering giving some additional banking licences to private sector players. Non-Banking Financial Companies could also be considered, if they meet the RBI's eligibility."* In this context, I would like to elaborate a little on the process followed by RBI to formulate the policy for licensing of new banks in the private sector given the implications for banking sector and the national economy.

The policy formulation process

14. In pursuance of the announcement made by the Honorable Finance Minister, the Reserve Bank of India prepared a Discussion Paper on *Entry of New Banks in the Private Sector* marshalling the international practices in licensing of banks, Indian experience and the ownership and governance issues. RBI put out the Discussion Paper on its website on August 11, 2010 for comments.

15. The Discussion Paper flagged various issues, primarily:

- What should be the minimum capital requirement for the new banks?
- What should be the minimum and maximum shareholding by the promoters and other shareholders?
- What should be the limit on foreign shareholding?
- Whether industrial and business houses should be allowed to promote banks?
- Should Non-Banking Financial Companies (NBFCs) be allowed to convert into banks and/or the promoters of NBFCs be allowed to promote new banks?
- What should be the business model of the new banks?

16. The Discussion Paper generated extensive debate in the general public, the media, by the consultants, existing banks, industrial and business houses, Non-Banking Financial Companies, Micro Finance Institutions, etc. The Reserve Bank also held discussions with important stakeholders. In order to have transparency, the gist of comments received on the Discussion Paper was placed on the RBI's website on December 23, 2010. Subsequently, the draft guidelines on "Licensing of New Banks in the Private Sector" were framed taking into account the experience gained from the functioning of the banks licensed under the guidelines of 1993 and 2001 and the feedback and suggestions received in response to the Discussion Paper and in consultation with the Government of India. The draft guidelines were placed on the RBI's website on August 29, 2011 for comments.

17. The comments received on the draft guidelines were examined. The Reserve Bank had indicated in the draft guidelines that certain amendments to the Banking Regulation Act, 1949 were under the consideration of the Government of India and final guidelines will be issued and the process of inviting application for setting up of new banks in the private sector

would be initiated only after the Banking Regulation Act, 1949 is amended. It was essential that the extant banking laws were amended to empower Reserve Bank of India to effectively deal with new banks in the private sector.

18. After the amendments to the Banking Regulation Act, 1949 in December, 2012, the guidelines were finalized and placed in the public domain on February 22, 2013. Following the issue of guidelines, clarifications were sought by intending applicants, consultants, etc., on various aspects of the guidelines. Instead of replying to such queries on one-to-one basis, the Reserve Bank considered it appropriate to invite queries from all concerned and to place the clarifications to such queries in the public domain for the sake of equity and transparency. The replies to the queries were placed in public domain on June 3, 2013.

Important features of the current policy

19. I feel it would be appropriate on my part to elaborate on some of the important features of the guidelines that have generated a lot of debate, the rationale behind some such policy prescriptions and to explain how these guidelines are different from earlier guidelines. I will deal with the issues one by one.

Eligible entities to promote a bank

20. The first and foremost issue for the Reserve Bank was to decide who could be eligible to promote new banks considering the broader objective of setting up of these banks, its own experience of dealing with the promoters of the private sector banks in the past and not the least, the lessons learnt from the recent global financial crisis. The Reserve Bank had dealt extensively on this issue, including the issue of permitting industrial and business houses setting up banks, in the Discussion Paper, as I mentioned earlier. The pros and cons of allowing industrial and business houses had also been indicated in the Discussion Paper. In response, RBI received divergent views.

21. In the context of permitting industrial and business houses to promote banks, I would also like to mention that concerns had been raised by Prof. Joseph Stiglitz, the eminent economist, Dr. Y.V. Reddy, former Governor, RBI, and also in the IMF Staff Report. These concerns emanate from the likely conflict of interest in case industrial and business houses were allowed to own banks. In the last two rounds of licensing of banks in the private sector, as I mentioned earlier, industrial and business houses had not been allowed to promote new banks, partly out of these concerns.

22. Given the divergent views on the issue of permitting industrial and business houses to promote banks, we in RBI discussed and debated a lot internally. The international experience in this regard was of no profound guidance, as it differed from country to country. While countries like Australia, Brazil, Canada, Germany, France, Japan, UK, etc., do not specifically restrict industrial houses from setting up banks, there are restrictions in countries like USA and Korea. A few instances of banks owned by industrial houses are: Tesco Bank (U.K.), Virgin Money (U.K), Banco Ahorro Famsa (Mexico), Banco Azteca (Mexico), Techcom Bank (Vietnam), Transcredit Bank (Russia), MDM Bank (Russia), Alfa Bank (Russia), Volkswagen Bank (Germany), Mercedes-Benz Bank (Germany), BMW Bank (Germany), Siemens Bank (Germany), C & A Bank (Germany) and Alior Bank (Poland).

23. We, at RBI, believed that circumstances have changed a lot since nationalization of the major private sector banks in 1969 and in 1980, and more particularly since India embarked upon the path of economic liberalization since 1991. The banking and financial system have evolved stronger and vibrant over the years. It has been deepened and diversified. The overall economic transformation of India has also created a conducive environment for further liberalization of banking policy.

24. In this backdrop, the final guidelines for licensing of new banks in the private sector were formulated permitting entities/groups in the private sector that are "owned and

controlled by residents" and entities in public sector to promote banks through wholly owned Non-Operative Financial Holding Company (NOFHC). The Promoters/Promoter Groups with existing non-banking financial companies (NBFCs) were also permitted to apply for a bank licence, subject to compliance with other parameters. The guidelines, by implication, permit corporates to promote new banks.

25 Having said that, I would like to explain a little why RBI considered corporates for setting up of new banks. The main reasons for allowing corporate houses are:

- Industrial and business houses have already been permitted to operate in other financial services sectors such as insurance, mutual fund, etc., and are competing with banks both on the assets and liabilities side.
- Industrial and business houses have a long history of building and nurturing new businesses in highly regulated sectors such as telecom, power, airports, highways, dams and ports, etc.
- Industrial and business houses can be an important source of capital and can provide management expertise and strategic direction to banks as they have done to a broad range of non-banking companies and other financial companies.
- Equities of large industrial and business houses are widely held and are listed on the stock exchanges and are subject to Companies Act, SEBI rules and regulations on transparency, disclosure and corporate governance.
- Permitting industrial and business houses to own a limited number of banks should not lead to undue concentration of control of banking activities as the Indian banking system is largely dominated by public sector banks.
- Financial inclusion being the overall objective of the present bank licensing policy, it was considered that industrial houses with their deep pockets could fill the gap, as financial inclusion is a capital and technology intensive project.
- Industrial and business houses with presence across various sectors would not like to lose their reputation compared to a pure individual promoter or financial services player.

26. I have earlier spoken about the concerns raised in various quarters on the issue of permitting industrial and business houses to own banks. Therefore, I would like to mention how the new policy on banking licence addresses such concerns. We have built up adequate checks and balances in the new guidelines, some of which are as under:

- The guidelines have spelt out the "fit and proper" criteria for the Promoters. The Promoters/Promoter Group should be financially sound. They should have sound credentials and integrity and also a successful track record for at least 10 years of running business. Due diligence exercise will be carried out on the Promoters and Promoter Group entities for ascertaining these aspects, and RBI may seek feedback from other regulators and enforcement and investigative agencies, as deemed appropriate.
- The Promoters/Promoter Groups' business model and business culture should not be misaligned with the banking model and their business should not potentially put the bank and the banking system at risk on account of group activities such as those which are speculative in nature or subject to high asset price volatility.

27. Now, I would like to explain how we addressed the issues relating to conflict of interests.

- First, the guidelines provide that the Promoters/Promoter Groups, if found suitable for setting up a bank, would be required to first set up a wholly owned Non-Operative Financial Holding Company (NOFHC), which will hold the new bank and other regulated financial services entities of the Group. The objective is that the Holding Company should ring fence the regulated financial services entities of the Group, including the bank from other activities of the Group i.e., commercial, industrial and financial activities not regulated by financial sector regulators and also that the bank should be ring fenced from other regulated financial activities of the Group. The NOFHC will be registered with the Reserve Bank as an NBFC and will comply with bank-like corporate governance guidelines and prudential norms. The capital structure of the NOFHC has also been laid down. Only non-financial services companies/entities and non-operative financial holding company in the Group and individuals belonging to the Promoter Group will be eligible to hold shares in the NOFHC and at least 51 per cent of the total voting equity of the NOFHC should be held by companies in the Promoter Group in which public hold not less than 51 per cent of the voting equity.

- Secondly, in the interest of diversified ownership, the banks should be widely held. Accordingly, it has been provided in the guidelines that the shareholdings of the NOFHC in the bank would be diluted to 15 per cent over a period of 12 years. No single entity or group of related entities, other than the NOFHC shall have shareholding or control, directly or indirectly, in excess of 10 per cent of the paid-up voting equity capital of the bank. Any acquisition of shares, which takes the aggregate holding of an individual/entity/group to the equivalent of 5 per cent or more of the paid-up voting equity capital of the bank would require prior approval of RBI. Additionally, the bank is required to list its shares within 3 years from the commencement of business to have diversified ownership and to ensure accountability and transparency through adequate disclosures.
- Thirdly, with a view to mitigating conflict of interest and to ensure that there is no self-dealing, the new banks will not be permitted to take any credit and investments (including investments in the equity/debt capital instruments) exposure on the Promoters/Promoter Group entities or individuals associated with the Promoter Group or their NOFHCs. Further, the banks promoted by Groups having 40 per cent or more assets/income from non-financial business will require RBI's prior approval for raising paid-up voting equity capital beyond ₹ 10 billion for every block of ₹ 5 billion. The above prudential norms coupled with adequate safeguards would ring fence the banking entity.
- Fourthly, with the recent amendments to the Banking Regulation Act, 1949, RBI has been empowered to call for information relating to the business or affairs of any associate enterprise of the banking company and also cause an inspection of its books of account. The amended Act also provides adequate powers to RBI to supersede the Boards of the banks to secure proper management.

Minimum capital required for the new bank

28. The minimum capital requirement for the new banks is another issue on which views were divergent. The international experience also differed across countries. The capital requirement should neither be too low to achieve the goals of financial inclusion nor too high to become an impediment for those who are committed to the goal. We thought ₹ 5 billion would be a reasonable amount and the same was prescribed in the guidelines.

Foreign shareholding in the new bank

29. Currently, the foreign shareholding in the private sector banks is capped at 74 per cent as per the FDI policy of the Government of India. With foreign shareholding of more than 50 per cent, a domestic bank becomes a foreign owned bank. Therefore, allowing the new banks to be foreign owned from the very beginning may not be a good idea, as RBI operates a separate window for foreign banks in India and pursuing the subsidiarisation of

foreign banks' presence in India from the perspective of strengthening financial stability. It was, in that context, considered appropriate to stipulate a lower limit of 49 per cent for the first five years, after which the extant FDI limits would kick in.

Corporate governance and exposure norms

30. Corporate governance and prudential exposure norms are important aspects of new bank policy; more so, in the context of allowing corporates to own banks. The guidelines for licensing of new banks deal on the subjects extensively. The guidelines mandate the NOFHC to have at least 50 per cent independent directors on its Board and they should have special knowledge or practical experience in economics, finance, accountancy, banking, insurance, law and some such fields. The NOFHC shall not have any credit and investment (including equity/debt capital) exposure to any entity belonging to the Promoter Group except those held under it and the new bank cannot take any credit and investment (including investments in equity/debt capital) exposure on Promoters/Promoter Group entities or individuals associated with the Promoter Group or the NOFHC.

Financial inclusion

31. One of the main planks of licensing policy is to assess how the banks would serve public interest. The guidelines require the promoters to address how the bank proposes to achieve financial inclusion, comply with the priority sector lending targets and minimum 25 per cent branch presence in rural unbanked centres. The project report and the business plan of each applicant will be evaluated to make an assessment about these aspects.

Fairness and transparency of licensing process

32. The fairness and transparency of the licensing process are no less important given the enthusiasm shown by the corporate houses, NBFCs and public sector entities to get banking licence. I may also add that there were suggestions from certain quarters for auctioning of new bank licences. No doubt, banks are for public good. But, banks are special. They are highly leveraged financial institutions. They are the conduits for monetary policy transmission and constitute the core of payment and settlement system. They accept uncollateralized deposits from members of public and their deposits are insured. The purpose of issuing new bank licences is to serve public interest. Auctioning of bank licences is unheard of in any jurisdiction. Nevertheless, issues relating to fairness and transparency were to be dealt with. It was, therefore, decided to place the names of the applicants for bank licences on the RBI's website after the last date of receipt of applications. Accordingly, RBI disclosed the names of 26 applicants. The applications are being subjected to a multi-layered scrutiny internally by the Reserve Bank followed by scrutiny by a High Level Advisory Committee that would comprise eminent persons with impeccable integrity and experience in banking, financial sector and other relevant areas. The High Level Committee will make recommendations to the RBI and the final selection will be that of the RBI.

Implications of new bank licensing

33. In the above context, I would like to share my personal views on the implications of new bank licensing. The new bank licensing under the current guidelines will have implications for the Promoters in particular, who get the licence, for the banking industry in general, for the economy, for the common man, and also for the Reserve Bank, as regulator and supervisor for the banks. I will discuss these implications one by one.

Implications for the promoter

34. As I mentioned earlier, the Promoters/Promoter Group have to first set up a non-operative financial holding company (NOFHC) for holding the new bank and other regulated financial services entities, in which the Promoters/Promoter Group have significant influence or control.

- First of all, for setting up of NOFHC, the Promoters/Promoter Groups have to identify companies which will hold the voting equities of the NOFHC. As the guidelines require that at least 51 per cent of the voting equity of the NOFHC should be held by a company/companies in the Promoter Group, in which public hold not less than 51 per cent of the voting equity, the Promoters have to necessarily dilute their shareholdings in such companies to comply with the requirement, if there are no such companies for the present.
- Secondly, the Promoters/Promoter Groups have to re-organize their business structure in respect of the financial services that they undertake through the Group entities. They have to move all the regulated financial services entities, in which they have significant influence or control, into the fold of NOFHC. What this means is that, they cannot hold the voting equity of the financial services entities directly, but only through the NOFHC. This would require some amount of restructuring of their financial services business.
- Thirdly, Promoters/Promoter Groups currently undertaking various types of lending business through non-banking financial companies (NBFCs) would have to transfer the lending business to the new bank. As per the guidelines and the clarifications issued, lending activities must be conducted from inside the bank. But, para-banking activities, such as credit cards, primary dealer, leasing, hire purchase, factoring etc., can be conducted either inside the bank departmentally or outside the bank through subsidiary/joint venture/associate structure. Activities such as insurance, stock broking, asset management, asset reconstruction, venture capital funding and infrastructure financing through Infrastructure Development Fund (IDF) sponsored by the bank can be undertaken only outside the bank. This would require some amount of demerger of business for Groups that have NBFCs for lending business. They have the option of converting such NBFC into the new bank, provided all the activities that the NBFC currently undertakes could be undertaken by the new bank departmentally. Otherwise, activities that banks are not permitted to undertake departmentally have to be demerged/divested into other entities or wound down.
- Fourthly, the Promoters/Promoter Groups converting the NBFCs into the new banks or transferring the business from NBFCs into the new banks will have to comply with the cash reserve ratio (CRR), statutory liquidity ratio (SLR) and priority sector lending (PSL) targets in respect of the liabilities and loan assets taken over from the NBFCs, once the new bank commences its business.
- Fifthly, the Promoters/Promoter Groups have to comply with the requirement of opening of 25 per cent of their total number of branches in unbanked rural centres. The rule will apply in case of conversion of existing NBFCs into new banks, and therefore, the Promoters/Promoter Groups have to plan their business accordingly.
- Sixthly, the bank and financial entities held by NOFHC shall not have any credit and investments (including investments in the equity/debt capital instruments) exposure to the Promoters/Promoter Group entities or individuals associated with the Promoter Group or the NOFHC.

35. The implications for the Promoters/Promoter Groups discussed above would vary depending upon the number of regulated financial services entities in the Group, the size of their business and their present business structure. Considering these implications, RBI has extended the validity of “in-principle” approval from 12 months to 18 months from the date of issue, for the Promoters/Promoter Group to comply with all such matters during this time, but before the banks commence the business.

Implications for the banking industry

36. A few new banks would enter the banking industry after a decade with the last such licence issued in 2004. However, they would be the game changer in many aspects. I would like to mention how their presence would have implications for the banking industry.

- First and foremost, with the setting-up of new banks under the NOFHC, financial holding company (FHC) structure will be introduced in the banking industry for the first time. This will be a marked departure from the present bank-subsidiary model under which Indian banks operate. The Government of India is also contemplating a holding company structure for public sector banks. The existing private sector banks are expected to follow suit, in line with the Shyamala Gopinath Committee recommendations.
- Secondly, the new banks will bring in new business model, new products, new processes, new technologies, etc. The level of productivity, efficiency and customer service would be expected to be higher. The existing banks may have to re-orient some of their businesses, technologies, etc.
- Thirdly, the existing banks would face competition, both on their assets and liabilities side of the balance sheet, from the new generation banks and have to devise ways to withstand the competition or they may lose their existing customers, who may move away to new banks. Banks that cannot compete would be vulnerable to acquisitions/take over. Possibility of voluntary amalgamation amongst some banks cannot be ruled out.
- Fourthly, the public sector banks, as a group have a dominant market share of about 72 per cent. They are likely to shed some weight over time and the share of private sector banks as a group would increase.
- Fifthly, Indian financial system is bank dominated. The financial system will be broadened and deepened with the entry of new banks in the private sector. The market share of the banks, as a segment, in the financial system's assets would increase over non-banks, if the business houses with major NBFCs come out successful in getting bank licences. In that case, they would convert NBFCs into new banks or transfer the lending activities of the Group NBFC into the new bank, as per the requirement.

Implications for the economy

37. Finance is fuel for the economy. Banks being at the core of the financial system, provide this fuel. The progress of the real economy depends upon the growth of the banking and financial system. An efficient financial system transforms the savings into investments and channelizes the investments to productive sectors of the economy to spur growth. India is an emerging market economy and has the potential to grow faster. As the Indian economy refocuses on the expansion of manufacturing and infrastructure sectors, the credit needs of the real economy would be much higher compared to the services sector. Entry of new banks would, in a way, help in the economic development of the country.

Implications for the common man

38. Financial inclusion is the basic tenet of new bank licensing policy. As per the data furnished in Basic Statistical Returns (BSR) of banks, it is estimated that rural India had only 7 branches per 100,000 adults in 2011 in sharp contrast to most of the developed countries and even BRICS nations having over 40 branches. Further, certain regions, such as, north-eastern, eastern and central regions, are more excluded in terms of banking penetration. Entry of new banks, with the mandated opening of 25 per cent of brick and mortar branches in unbanked rural centres, would cover regions that were hitherto financially excluded.

39. The common man would be benefitted from the innovative products and superior banking technology of the new generation banks. They would be able to reach out to the masses more easily by use of information and communication technology (ICT) enabled devices.

Implications for the reserve bank

40. In the context of new bank licensing, serious concerns have been raised on the issue of allowing industrial/business houses to own banks. This would be a new experiment in India after nationalization of commercial banks in 1969. The RBI's regulatory and supervisory effectiveness will be tested in preventing the new banks promoted by industrial and business houses from self-dealing. The new bank guidelines have adequate arrangements for ring-fencing of the financial services activities of the Promoter Groups from their non-financial (manufacturing/trading/others) activities and addressed the issues concerning conflict of interests by prohibiting lending to and investments in Promoter Group entities. RBI has also been vested with adequate powers through amendments to the Banking Regulation Act, 1949 to supervise these banks in a consolidated manner. However, it is yet to be tested whether the ring-fence would work effectively or could be circumvented. Therefore, we in the RBI need to be extra vigilant to protect the interests of the depositors.

Banking structure in India – The way forward

41. This bank licensing policy is for now. How about the future? The Reserve Bank reviewed the extant Banking Structure in India keeping in view the recommendations of, *inter alia*, the Committees on Financial/Banking Sector Reforms, 1991 and 1998 (Chairman: Shri M. Narasimham), the Committee on Financial Sector Reforms, 2009 (Chairman: Dr. Raghuram G. Rajan) and a few other relevant viewpoints and placed a Discussion Paper on the RBI website on August 27, 2013 for comments.

42. The Discussion Paper has taken into consideration the specific requirements of the Indian economy as well as the lessons learnt from the global financial crisis particularly relating to banking structure while reviewing the Indian banking structure. Certain building blocks for the reoriented banking structure have been identified with a view to addressing various issues such as enhancing competition, financing higher growth, providing specialized services and furthering financial inclusion. At the same time, the need to address the concerns arising out of such changes with a view to managing the trade-off for ensuring financial stability is also emphasized.

43. The Discussion Paper also covers the debate on having a large number of small banks for promoting financial inclusion vis-à-vis a few large banks having global presence; universal banking and differentiated licensing for infrastructure financing, whole sale banking and retail banking; need for consolidation in the banking sector; conversion of urban co-operative banks (UCBs) into commercial banks/LABs; policy for presence of foreign banks in India and Indian banks' presence overseas; ownership issues and the need for having an effective resolution regime to deal with failure of banks. It also envisages a reoriented banking system with distinct tiers of banking institutions with the first tier consisting of three or four large Indian banks with domestic and international presence along with branches of foreign banks in India, the second tier comprising several mid-sized banking institutions including niche banks with economy-wide presence. The third tier and fourth tiers will encompass old private sector banks, RRBs, multi state UCBs and small local and cooperative banks, respectively. I hope NIBM will provide a platform to generate a debate on this Discussion Paper for an appropriate banking structure for India.

Conclusion

44. Let me now conclude. I started with a broad picture of the Indian financial and banking system as a backdrop to today's discussions. I dealt with a historical perspective of

banking developments in India and the need for new banks in the private sector. I touched upon the genesis for the new bank licensing guidelines and specifically covered some of the debatable features of the guidelines such as allowing industrial/business houses to set up banks, minimum capital requirement, foreign shareholding in these banks, corporate governance and exposure norms, thrust on financial inclusion, fairness and transparency of the licensing process, etc. I also shared my personal thoughts on its implications for the promoters of banks and banking industry, economy as a whole, and for common man and RBI. The way forward for Indian banking structure as put out by RBI in its Discussion Paper needs to be debated. As the objective of this conclave is to explore the various implications of the new bank licensing, I will look forward to your views. There could be different perspectives.

45. I once again thank NIBM for providing me an opportunity to share my thoughts on the subject and wish meaningful deliberations in this conclave.

Thank you.